

STATE OF CALIFORNIA

DEPARTMENT OF INSURANCE

45 Fremont Street, 24th Floor

San Francisco, California 94105

REVISED AMENDED FINAL STATEMENT OF REASONS/REVISED UPDATED INFORMATIVE DIGEST

Date: December 11, 2006 RH02024219

REGULATIONS CONCERNING MUTUAL FUND INVESTMENTS IN VARIABLE PRODUCTS PURSUANT TO INSURANCE CODE SECTION 10506

UPDATE OF INITIAL STATEMENT OF REASONS/UPDATED INFORMATIVE DIGEST

Pursuant to Insurance Code Section 10506, Insurance Commissioner John Garamendi proposes to add to Article 11.3 of the California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Sections 2534.40, 2534.41, 2534.42, 2534.43, 2534.44, 2534.45 and 2534.46 entitled "Mutual Fund Investments in Variable Products". Insurance Code Section 10506 permits the Commissioner to establish filing requirements for applications to amend an insurer's variable authority and to clarify which filings qualify for the treatment specified by Insurance Code section 10506(h). In addition, the regulations will establish criteria for determining if a variable product involves a hazardous operation.

Public comment was accepted and a public hearing was held on this proposed regulation on July 1, 2005. After considering the public comment during the initial 45 day period, initially the Commissioner decided not to make any changes to the proposed regulations. After receiving a Decision of Disapproval of Regulatory Action from the Office of Administrative Law, the Commissioner decided to make changes to the proposed regulations. Notice of the proposed changes was issued on September 21, 2006. The 15 day public comment period on these proposed changes ran from September 22, 2006 through October 6, 2006.

The following changes were made to the proposed regulations:

1. Former proposed Section 2534.41 has been deleted. Proposed Sections 2534.43 and 2534.45(a)(9) were also deleted. After concerns were raised concerning the Commissioner's authority to promulgate these sections, the Commissioner elected to eliminate these sections.
2. In the new proposed Section 2534.41, language has been added to clarify the use of the terms subaccounts and portfolios, the use of the term variable product, and to provide a definition of what constitutes a hazardous operation.

3. In the new proposed Section 2534.44, the former subsection (g) (2) has been eliminated. After receiving additional input from the Department's Financial Analysis Division, the Commissioner determined that the Department is no longer using the General Assets test that was described in this section. As a result, the language in this subsection was no longer necessary.
4. Similarly, the former subsection (g) (7) of Section 2534.44 was also eliminated. This subsection had used an excessive number of subaccounts as an indicator of a hazardous operation. After reviewing the language of the proposed regulations, the Commissioner determined that it would be best to allow the free market to determine whether the number of subaccounts in a variable product was excessive. This determination was made in part due to the belief that the types of investors who typically purchased variable products were generally more sophisticated than the general public.
5. In proposed Section 2534.46, language was added to expand the scope of inquiry concerning disciplinary actions to include actions taken by other agencies other than the Securities and Exchange Commission. This change was made in response to a comment by the Department of Corporations.
6. The remaining changes were made to improve the clarity of the proposed regulations.

After the public comment period on the noticed proposed changes closed on October 6, 2006, it was discovered that there were several typographical errors in the text of the proposed regulations. As a result, in the New Matters Form in proposed Section 2534.46(a)(2), the reference in question 4d was changed from Section 2534.41(b)(4) to Section 2534.42(b)(4). These errors resulted from the renumbering of the sections of the proposed regulations and do not have any regulatory effect. In proposed Section 2534.41(a), the reference to the Investment Company Act of 1940 was changed to a reference to the Investment Advisors Act of 1940. After receiving public comment on this change and reviewing Insurance Department Bulletin 97-2, it was discovered that the correct reference was to the Investment Company Act of 1940. The erroneous reference was posted in the proposed changes due to a typographical error in the original text of the proposed regulations. In the original text, the citation was made to 15 U.S.C. 80b-1 when the citation should have been 15 U.S.C. 80a-1. Since insurers have been operating under Insurance Department Bulletin 97-2's reference to the Investment Company Act of 1940, restoring this language will not have any regulatory effect because it was not the intent of the Commissioner to change this statutory reference.

Subsequently, a copy of Insurance Department Bulletin 97-2 was included in the rulemaking file for ease of reference and responses to comments. A copy of Insurance Department Bulletin 97-2 is readily available from the Department of Insurance and is easily accessed on the Department of Insurance website, www.insurance.ca.gov. Insurance Code Section 10506 expressly permitted the Commissioner and insurers to rely upon Insurance Department Bulletin 97-2 until the promulgation of regulations to supersede the Bulletin.

Because the Initial Statement of Reasons, with the exception of certain responses to public comments, still fully and accurately reflects the views of the Department of Insurance, the Commissioner incorporates by this reference the Initial Statement of Reasons.

IDENTIFICATION OF STUDIES

No material, other than this Amended Final Statement of Reasons and the revised responses to public comments, has been added to the rulemaking file since the time that the rulemaking record was originally closed. No other material was relied upon by the Commissioner. There have been no changes in applicable laws or to the effect of the proposed regulations from the laws and effects described in the Notice of Proposed Regulatory Action.

AMENDED SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE INITIAL NOTICE PERIOD OF MAY 13, 2005 THROUGH JULY 1, 2005

Summary and Response to Comments Re: Sections 2534.40, 2534.41, 2534.42, 2534.43, 2534.44, 2534.45, 2534.46 and 2534.47

Comment No. 2:

Commentator: Andrew Loeb, McNitt & Loeb

Date of Comment: June 29, 2005

Type of Comment: Electronic mail

Summary of Comment:	Response to Comment: The Commissioner has considered the comment and has not changed the proposed regulations in response to the comment.
(a) The Terms “Variable Product” And “Variable Contract” Are Used Interchangeably In Sections 2534.43, 2534.44 And 2534.45 Of The Proposed Regulations The commentator notes that the terms “variable product” and “variable contract” seem to be used interchangeably in Sections 2534.43, 2534.44 and 2534.45 of proposed regulations. The commentator suggests that the term “variable product” be used throughout the proposed regulations.	(a) The Terms “Variable Product” And “Variable Contract” Are Used Interchangeably In Sections 2534.43, 2534.44 And 2534.45 Of The Proposed Regulations Although the commentator makes a reasonable request, the Commissioner believes that the proposed regulations as currently drafted are clear and do not cause any confusion about the use of the terms “variable product” and “variable contract”. The terms “variable product” and “variable contract” are terms of art that are commonly used by insurers and others associated with the insurance industry. In fact the terms were used extensively in Insurance Department Bulletin 97-2, which is

	being superseded by these proposed regulations.
<p>(b) Section 2534.44 Makes Reference To Brokers And Agents, But California Does Not License Life (Or Variable Life) Brokers</p> <p>The commentator states that the reference to brokers in Section 2534.44 of the proposed regulations should be deleted because the State of California does not license life or variable life brokers.</p>	<p>(b) Section 2534.44 Makes Reference To Brokers And Agents, But California Does Not License Life (Or Variable Life) Brokers</p> <p>As currently drafted, this section, which is now numbered as Section 2534.43 makes no reference to brokers or agents.</p>
<p>(c) Sections 2534.45, 2534.46(a)(5) And 2534.47(a)(5) Contain References To Portfolios</p> <p>The commentator states that the reference to portfolios in Sections 2534.45, 2534.46(a) (5) and 2534.47(a) (5) of the proposed regulations may have been made in error and perhaps should be deleted.</p>	<p>(c) Sections 2534.45, 2534.46(a)(5) And 2534.47(a)(5) Contain References To Portfolios</p> <p>Although an attempt was made to standardize the usage of certain terms, the term portfolio is still used as a term of art in the insurance and securities industries and the use of the term portfolio in these proposed regulations is intentional. In fact, Section 2534.41(c) explicitly states that the terms portfolios and subaccounts are interchangeable in these proposed regulations.</p>

Comment No. 3:

Commentator: Andrew Loeb, McNitt & Loeb on behalf of Principal Life Insurance Company

Date of Comment: June 29, 2005

Type of Comment: Written

Summary of Comment:	Response to Comment: The Commissioner has considered the comment and has not changed the proposed regulations in response to the comment.
(a) The Title of The Proposed Regulations Should Be Changed The commentator suggests that the proposed name of the new Article 11.3 of the proposed regulations be revised. Instead of being titled “Mutual Fund Investments in Variable Products”, the commentator suggests that the title be changed to “Amending Variable Product Qualifications”. The commentator believes that the title change would more accurately reflect the scope an impact of the proposed regulations.	(a) The Title of The Proposed Regulations Should Be Changed After considering the comment, the Commissioner does not believe that the current title of the proposed regulations is misleading and sees no reason to change the title.
(b) The Proposed Regulations Should Specifically Define And Formally Establish Letter Of Acknowledgement Procedures The commentator believes that the proposed regulations should set out the process for acknowledgement of applications for changes in variable products authorities. The commentator is concerned that there will be no legal basis for the current letter of acknowledgment procedure once Bulletin 97-2 is superseded by these proposed regulations.	(b) The Proposed Regulations Should Specifically Define And Formally Establish Letter Of Acknowledgement Procedures After considering the comment, the Commissioner does not agree that the acknowledgement process needs to be set out in the proposed regulations. Pursuant to these regulations, the need for acknowledgement letters will greatly decrease and each letter may discuss factors which are unique to that particular application. As a result, there may not be a standard acknowledgement letter. In addition, the legal authority for these regulations is Insurance Code section 10506. Although the Commissioner has continued to send acknowledgment letters in the form authorized under Insurance Department Bulletin 97-2 pursuant to Insurance Code section 10506(h) which continued the Bulletin's effectiveness, the amendments in AB 2778

	<p>specifically state that notification of any material change shall not be subject to the commissioner's prior acknowledgment. Since the commissioner is no longer required to acknowledge files, there is no need to promulgate a new form nor to establish an "acknowledgment process" as advocated by the commentator. The commissioner expects to send filers a notification of receipt of filing, but since 10506(h) specifically provides that filings are effective upon receipt by the commissioner, companies have no need to await such receipts, particularly where they choose to include (as do many filers) a self-addressed, stamped receipt card to be returned when a file is opened. Moreover, because the contents of a complete filing vary depending on the investments or products presented, the form of any receipt will vary from filing to filing and in any event is not an impediment to the marketing of variable products.</p>
<p>(c) The Proposed Regulations Fail To Define The Prior Approval And Acknowledgement Procedures</p> <p>The commentator asserts that the proposed regulations fail to define the prior approval and acknowledgement procedures. The commentator seeks clarification of what items may use "file and use" procedures.</p>	<p>(c) The Proposed Regulations Fail To Define The Prior Approval And Acknowledgement Procedures</p> <p>The commentator appears to be discussing former proposed Section 2534.41. After considering this comment, the Commissioner decided to delete the former Section 2534.41 which referred to certain material changes being subject to the Commissioner's prior approval. Further, the proposed regulations are designed to detail the factors to be considered in determining if hazardous operations are involved in variable products and the proposed regulations also set out what constitutes a complete filing. Insurance Code section 10506 makes no reference to the term "file and use".</p>
<p>(d) The Proposed Regulations Do Not Set Clear Criteria For The Types of Changes That Qualify for "File And Use" Treatment</p> <p>The commentator asserts that the proposed regulations fail to set clear criteria for the types of changes in variable products that qualify for "file and use" treatment. The commentator also</p>	<p>(d) The Proposed Regulations Do Not Set Clear Criteria For the Types of Changes That Qualify for "File And Use" Treatment</p> <p>As stated previously, the enabling statute, Insurance Code section 10506 does use the term "file and use". Instead, the statute discusses the types of changes that do not require the</p>

discusses certain types of changes that can occur without prior notice to the insurer. The commentator questions whether such changes should be required to be reported to the Commissioner.	Commissioner's prior approval or acknowledgement prior to implementation. In these proposed regulations, an attempt has been made to allow such changes to be implemented in a timely fashion while allowing the Commissioner to review such filings to determine if hazardous operations are involved that could endanger consumers. As a result, the Commissioner has considered the comment and elected not to adopt the criteria requested by the commentator.
(e) The Definition Of Mutual Fund Investments Is Not Broad Enough To Encompass Plans That Are Exempt From Registration Under The Investment Company Act of 1940 The commentator asserts that the definition of Mutual Fund Investments is not broad enough. In particular, the commentator is concerned that the definition would not cover group annuity contracts that are exempt from registration under the Investment Company Act of 1940.	(e) The Definition Of Mutual Fund Investments Is Not Broad Enough To Encompass Plans That Are Exempt From Registration Under The Investment Company Act of 1940 Although the group annuity contracts that the commentator discusses are not specifically mentioned in the definition of Mutual Fund Investments, such contracts are contemplated by the proposed regulations. In proposed Section 2534.42, retirement plans such as the type described by the commentator are not presumed to involve hazardous conditions.
(f) The Proposed Regulations Do Not Contain Definitions of Certain Terms The commentator asserts that proposed regulations do not define certain terms such as "New Product" and "New Fund".	(f) The Proposed Regulations Do Not Contain Definitions of Certain Terms The proposed regulations are codifying terms that have been used in Insurance Department Bulletin 97-2. The terms "New Product" and "New Fund" have become terms of art that are understood by insurers and their representatives. The usage of such terms has not caused any confusion.
(g) The Proposed Regulations Contain Ambiguities Concerning Mutual Fund Investments The commentator asserts that there are ambiguities concerning the use of the term Mutual Fund Investments in the proposed regulations.	(g) The Proposed Regulations Contain Ambiguities Concerning Mutual Fund Investments Other than the use of capitalization of the term of Mutual Funds Investments, the Commissioner does not agree that there are ambiguities concerning the use of the term Mutual Funds Investments. The changes requested by the commentator would change the meaning of the regulations and are rejected.

<p>(h) The Proposed Regulations Do Not Distinguish Between “File And Use” Filings And Other Filings</p> <p>The commentator suggests that the proposed regulations should explicitly state that there are three methods available to qualify various changes to variable programs: prior approval request filings, letter of acknowledgement request filings and “file and use” filings.</p>	<p>(h) The Proposed Regulations Do Not Distinguish Between “File And Use” Filings And Other Filings</p> <p>The proposed regulations and the enabling statute, Insurance Code section 10506, do not make any reference to the term “file and use”. The proposed regulations focus on whether Mutual Fund Investments are involved in determining how such filings should be handled.</p>
<p>(i) The Proposed Regulations Should Delete The Term “Stock”</p> <p>The commentator asserts that section 2534.45(g) (10) should not use the word “stock” in discussing index subaccounts because some index subaccounts are not based on stock indices.</p>	<p>(i) The Proposed Regulations Should Delete The Term “Stock”</p> <p>The use of the word “stock” in section 2434.45(g) (10) of the proposed regulations is intentional. As stated previously, these proposed regulations, in part, are designed to codify terms previously used in Insurance Department Bulletin 97-2. The term has become a term of art in the insurance and securities industries. The usage of this term has not caused any confusion in the past.</p>
<p>(j) A Corporate Seal On A Certificate Of Compliance Should Not Be Required If The Certificate Is Executed By A Corporate Officer</p> <p>The commentator suggests that the corporate seal requirement be replaced by a requirement that the Certificate of Compliance be executed by an executive officer of the insurer who has responsibility for the insurer’s variable contract operations. Requiring a notarized signature would make the corporate seal requirement unnecessary.</p>	<p>(j) A Corporate Seal On A Certificate Of Compliance Should Not Be Required If The Certificate Is Executed By A Corporate Officer</p> <p>Since every insurer has access to a corporate seal, the Commissioner does not believe that this requirement is overly burdensome. However, after the regulations take effect, if it is later determined that this an overly burdensome requirement, the Commissioner will consider amending this section in the future.</p>
<p>(k) Private Placement Memorandums Are Not Generally Filed With The Securities And Exchange Commission</p> <p>The commentator asserts that Private Placement Memorandums are not generally filed with the Securities and Exchange Commission.</p>	<p>(k) Private Placement Memorandums Are Not Generally Filed With The Securities And Exchange Commission</p> <p>The Commissioner believes that it is common practice for insurers and investment companies to file a Private Placement Memorandum with the Securities and Exchange Commission. In any event, if such a Memorandum is not filed with the Securities and Exchange Commission, then the proposed regulation would not require</p>

	<p>that it be part of the filing made with the Department. Under Insurance Department Bulletin 97-2, which was continued in effect pending these regulations by AB 2778, the new product, fund, subaccount, and other material changes forms all requested that if a particular variable product or underlying investment was not subject to filing with the SEC that "other documentation which provides information" should be submitted. In the case of private placement investments, many insurers have found that a private placement memorandum, if one is prepared, is a convenient document to include as it provides full disclosure of relevant information about the investments. The specific references to private placement memoranda in the forms reflect this common practice among filers and do not require preparation of one.</p>
<p>(l) The New Product Form Is Confusing Because It Does Not Distinguish Between Front-End Loads And Commission Payments To Sales Agents</p> <p>The commentators assert that the proposed regulations' New Product Form is Confusing because it does not distinguish between front-end load charges to consumers and commission payments to sales agents.</p>	<p>(l) The New Product Form Is Confusing Because It Does Not Distinguish Between Front-End Loads And Commission Payments To Sales Agents</p> <p>The New Product Form has been used pursuant to Insurance Department Bulletin 97-2 for several years. The form asks for the amount of sales commission on the New Product. Filers are free to distinguish between front-end load charges to consumers and commission payments to sales agents if they wish. Limiting the inquiry to front-end load charges would be overly limiting and Insurance Code Section 10506(h) requires the Commissioner to review sales commissions. The Commissioner is unaware of any prior complaints concerning this form and wants to encourage disclosure of all relevant sales charges. As a result, the form will remain unchanged.</p>
<p>(m) The Procedure For Filing Effective Prospectuses, Supplements And Statements Of Additional Information Should Be Changed</p> <p>The commentator requests that insurers be permitted to file the final form prospectus with the Department on or shortly before the day it</p>	<p>(m) The Procedure For Filing Effective Prospectuses, Supplements And Statements Of Additional Information Should Be Changed</p> <p>Nothing in the proposed regulations prevents an insurer from taking the steps suggested by the commentator in filing the appropriate prospectus</p>

<p>becomes effective. The commentator also suggests other means of filing such documents on a timely basis with the Department.</p>	<p>or Statement of Additional Information documents with the Department. The proposed regulations require that a currently effective prospectus or Statement of Additional Information be filed with the Department. There is nothing in the proposed regulations that prevents an insurer from providing updated documents. The timing of the filing of the documents is controlled by the insurer, not the Department.</p>
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Comment No. 4:

Commentator: Randall A. Doctor, Barger & Wolen

Date of Comments: July 1, 2005

Type of Comment: Written (Two Letters)

<p>Summary of Comment:</p>	<p>Response to Comment: The Commissioner has considered the comment and has changed the proposed regulations in response to the comment.</p>
<p>(a) The Non-Mutual Fund Provisions Of The Draft Regulations Lack Statutory Authority And Must Be Removed</p> <p>The commentator asserts there is no statutory authority for the imposition of a filing requirement and a filing standard upon filings involving non-mutual funds. The commentator argues that Insurance Code section 10506(h) relates only to changes relating to mutual funds.</p>	<p>(a) The Non-Mutual Fund Provisions Of The Draft Regulations Lack Statutory Authority And Must Be Removed</p> <p>The commentator ignores the language in Insurance Code section 10506(h) which states: "The commissioner may make reasonable rules and regulations as he or she considers necessary, proper, and advisable concerning the issuance and delivery of these policies and contracts and the payment of benefits thereunder and the manner in which the separate accounts shall be administered and which types of policies and contracts, if any, shall be subject to his or her approval prior to issue."</p> <p>The proposed regulations have been promulgated, in part, as response to AB 2788 which the Legislature enacted in 2002. The Commissioner is aware that the legislature was enacted to enable speedier processing of</p>

	<p>notifications of material changes by insurers. However, there is nothing in the enabling statute, Insurance Code section 10506(h), that prevents the Commissioner from setting reasonable standards governing what constitutes a complete filing.</p> <p>However, upon further reflection, the Commissioner has decided to delete the language concerning material changes to non-mutual funds that was contained in the proposed Section 2534.41</p>
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Comment No. 7

Commentator: Timothy L. LeBas, California Department of Corporations

Date of Comment: July 14, 2005

Type of Comment: Written

Summary of Comment:	Response to Comment: The Commissioner has considered the comment and has changed the proposed regulations in response to the comment.
<p>(a) The Scope Of Inquiry Concerning Prior Disciplinary Actions Should Be Broadened To Include Other Agencies Besides The Securities And Exchange Commission</p> <p>The commentator asserts that the Commissioner should amend the proposed regulations to permit inquiries into disciplinary actions by agencies other than the Securities and Exchange Commission</p>	<p>(a) The Scope Of Inquiry Concerning Prior Disciplinary Actions Should Be Broadened To Include Other Agencies Besides The Securities And Exchange Commission</p> <p>After considering the comment, the Commissioner has decided to modify the proposed regulations to permit inquiries into disciplinary actions by agencies other than the Securities and Exchange Commission.</p>

Comment No. 8

Commentator: Randall A. Doctor, Barger & Wolen

Date of Comment: July 1, 2005

Type of Comment: Oral

Summary of Comment:	Response to Comment: The Commissioner has considered the comment and has changed the proposed regulations in response to the comment.
<p>(a) The Non-Mutual Fund Provisions Of The Draft Regulations Lack Statutory Authority And Must Be Removed</p> <p>The commentator asserts there is no statutory authority for the imposition of a filing requirement and a filing standard upon filings involving non-mutual funds. The commentator argues that Insurance Code section 10506(h) relates only to changes relating to mutual funds.</p>	<p>(a) The Non-Mutual Fund Provisions Of The Draft Regulations Lack Statutory Authority And Must Be Removed</p> <p>The commentator ignores the language in Insurance Code section 10506(h) which states: “The commissioner may make reasonable rules and regulations as he or she considers necessary, proper, and advisable concerning the issuance and delivery of these policies and contracts and the payment of benefits thereunder and the manner in which the separate accounts shall be administered and which types of policies and contracts, if any, shall be subject to his or her approval prior to issue.”</p> <p>The proposed regulations have been promulgated, in part, as response to AB 2788 which the Legislature enacted in 2002. The Commissioner is aware that the legislature was enacted to enable speedier processing of notifications of material changes by insurers. However, there is nothing in the enabling statute, Insurance Code section 10506(h), that prevents the Commissioner from setting reasonable standards governing what constitutes a complete filing.</p> <p>However, upon further reflection, the Commissioner has decided to delete the language concerning material changes to non-mutual funds that was contained in the proposed Section 2534.41</p>

**SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE 15 DAY
NOTICE PERIOD OF SEPTEMBER 22, 2006 THROUGH OCTOBER 6, 2006**

Comment No. 1:

Commentator: Andrew Loeb, McNitt & Loeb on behalf of Principal Life Insurance Company

Date of Comment: October 11, 2006

Type of Comment: Written

<p>Summary of Comment:</p>	<p>Response to Comment: The Commissioner has considered the comments and has changed the proposed regulations in response to the comments.</p>
<p>(a) The Proposed Regulations Provide "Unclear, Insufficient, Or No Guidance" Concerning The Time At Which "Other Changes" (Meaning Material Changes To Products Other Than Those Involving Mutual funds") May Be Implemented</p> <p>The commentator suggests that the proposed regulations fail to provide any guidance concerning the time at which changes that do not involve mutual funds take effect. The commentator advocates that the regulations should explicitly extend "file and use" treatment to all notifications. In the absence of such an extension, the commentator would like the regulations to explicitly indicate which filings qualify for "file and use" and which filings do not.</p>	<p>(a) The Proposed Regulations Provide "Unclear, Insufficient, Or No Guidance" Concerning The Time At Which "Other Changes" (Meaning Material Changes To Products Other Than Those Involving Mutual funds") May Be Implemented</p> <p>After considering the comment, the Commissioner believes that the commentator may have misunderstood the regulation. The regulation is intended to provide equivalent treatment for all variable products. As provided in Insurance Code Section 10506(h), material changes to all variable products are effective upon filing with the Commissioner. In addition, as previously indicated in responses to earlier comments by this commentator, Insurance Code Section 10506(h) does contain any reference to "file and use".</p>
<p>(b) The Proposed Regulations Would Better Reflect The Department's Practices If The Definition In Section 2534.41(a) Were Revised To Include Investments That Are Registered With The Securities And Exchange Commission Pursuant To The Investment Company Act of 1940 And Investments That Are Exempt From Registration Pursuant To Section 3(c)(11) Of The Investment Company Act Of 1940</p> <p>The commentator believes that the reference in</p>	<p>(b) The Proposed Regulations Would Better Reflect The Department's Practices If The Definition In Section 2534.41(a) Were Revised To Include Investments That Are Registered With The Securities And Exchange Commission Pursuant To The Investment Company Act of 1940 And Investments That Are Exempt From Registration Pursuant To Section 3(c)(11) Of The Investment Company Act Of 1940</p> <p>After considering the comment, the</p>

<p>proposed Section 2534.41(a) should be changed to reflect the Commissioner's current practices. Accordingly, the reference should be changed from Investment Advisers Act of 1940 to the Investment Company Act of 1940. In addition, the definition should be expanded to include investments which are exempt from registration pursuant to the Investment Company Act of 1940.</p>	<p>Commissioner has changed the reference in Section 2534.41(a) as requested. The change was erroneously made as explained elsewhere in this Final Statement of Reasons. In addition, the proposed regulations have attempted to use definitions similar to those used in Insurance Department Bulletin 97-2 because the Commissioner is well aware that insurers have become accustomed to the terminology used in the Bulletin.</p>
<p>(c) Section 2534.42(a) Of The Proposed Regulations Does Not Define What Constitutes An Investment</p> <p>The commentator asserts that the proposed regulations fail to define what an investment is for purposes of determining hazardous conditions. The commentator recommends that the regulations instead should make reference to variable products instead of investments.</p>	<p>(c) Section 2534.42(a) Of The Proposed Regulations Does Not Define What Constitutes An Investment</p> <p>The commentator ignores the definition of Mutual Fund Investment that is contained in proposed Section 2534.41(a). In addition, proposed Section 2534.42(b) (2) refers to investment portfolios that are registered under the Investment Company Act of 1940. The term investment has been used for several years in the insurance industry and no other commentator has indicated that they are confused by the use of the term investment.</p>
<p>(d) The Proposed Regulations Are In Conflict As To The Commissioner's Ability To Review Variable Contracts For Hazardous Operations</p> <p>The commentator notes that while Section 2534.42(b) sets out circumstances where hazardous operations would be found not to exist, Section 2534.42(c) permits the Commissioner to review a variable product for hazardous operations. The commentator argues that Section 2534.42(c) nullifies Section 2534.42(b) and that the two sections should be harmonized. The commentator suggests that the regulations should be changed to create a presumption that hazardous conditions are not present if the conditions described in Section 2534.42(b) exist. The commentator further recommends that the burden of proof be placed upon the Commissioner to prove that a hazardous condition exists.</p>	<p>(d) The Proposed Regulations Are In Conflict As To The Commissioner's Ability To Review Variable Contracts For Hazardous Operations</p> <p>Both Section 2534.42(b) and 2534.42(c) contain language that was used in Insurance Department Bulletin 97-2. By using this language, the Commissioner is attempting to maintain continuity in the proposed regulations. In order to make a finding of a hazardous operation, the Commissioner must make a finding of good cause that a contract poses a hazard for California policyholders or that a material risk was not adequately disclosed. In effect, the Commissioner must meet at least an initial burden of proof to show that a hazardous condition exists. In addition, the regulations call for the Commissioner to give notice of his findings to the insurer and the insurer is entitled to prepare a response. A mechanism has been established to give the insurer a hearing on the</p>

	issue of whether a hazardous condition exists.
<p>(e) The Regulations Require The Commissioner To Issue An Order To Prohibit Sale, Issuance Or Delivery Of A Variable Product If Hazardous Operations Are Found To Be Involved</p> <p>The commentator asserts that the only remedy available to the Commissioner if a hazardous operation is found to be involved in a variable product is the prohibition of the sale, issuance or delivery of the product. The commentator argues that this would result in overkill when other remedies may be more appropriate.</p>	<p>(e) The Regulations Require The Commissioner To Issue An Order To Prohibit Sale, Issuance Or Delivery Of A Variable Product If Hazardous Operations Are Found To Be Involved</p> <p>The Commissioner is not limited to ordering the prohibition of the sale, issuance or delivery or a variable product that involves hazardous operations. Section 2534.42(d)) (2) indicates that the Commissioner shall issue orders that include, but are not limited to the prohibition of the sale, issuance or delivery or a variable product that involves hazardous operations. In addition, the same Section gives the Commissioner the power to exercise all other powers provided in Article 14.5, Chapter 1, Part 2, Division 1 of the Insurance Code. Such powers would include remedies short of an outright ban on sales.</p>
<p>(f) It Is Unclear What Section 2534.43 Adds To Section 2534.42(c)</p> <p>The commentator asserts that Section 2534.42(c) already gives the Commissioner the ability to review variable contracts for possible hazardous operations. The commentator is concerned that the language in Section 2534.43 will make such review mandatory rather than discretionary. The commentator asks that the regulation be changed so that only variable products that are not described by Section 2534.42(b) are affected by Section 2534.43</p>	<p>(f) It Is Unclear What Section 2534.43 Adds To Section 2534.42(c)</p> <p>Since proposed Section 2534.43 has been deleted, this comment is now moot.</p>
<p>(g) The Effect Of A Notice Of Rejection Should Be Explicitly Stated In The Proposed Regulations</p> <p>The commentator asserts that the proposed regulations should set out the effect of a notice of rejection of a filing pursuant to Section 2534.43(b). The commentator recommends that the regulations should be revised to permit variable products to be qualified or amended on a file and use basis and be marketed in the state unless and until the Commission issues a notice</p>	<p>(g) The Effect Of A Notice Of Rejection Should Be Explicitly Stated In The Proposed Regulations</p> <p>AB 2778 and the proposed regulations permit filings of material changes to be immediately effective upon receipt by the Commissioner. As a result, the proposed regulations have the effect that the commentator has suggested. No other commentator has expressed any confusion with this portion of the proposed regulations.</p>

of rejection of the filing.	
<p>(h) Section 2534.43(a) Does Not Make Clear That An Insurer Is Entitled To A Hearing</p> <p>The commentator suggests that there was a typographical error in Section 2534.43(a). Instead of referring to Section 2534.43, the reference should be to Section 2534.42(c). The commentator contends that Section 2534.43(a) fails to make clear that an insurer would be entitled to a hearing to contest a finding by the Commissioner that hazardous operations were involved in a variable product.</p>	<p>(h) Section 2534.43(a) Does Not Make Clear That An Insurer Is Entitled To A Hearing</p> <p>Since proposed Section 2534.43 has been deleted, this comment is now moot.</p>
<p>(i) The Proposed Regulations Should Not Require Insurers To Resubmit Documentation On Disciplinary Matters</p> <p>The commentator asserts that the New Fund Form and New Subaccount Form in Section 2534.46 continue to require insurers to submit disclosures of disciplinary actions against broker-dealers or investment advisors involved with a variable product. The commentator suggests that previously submitted documentation should be excluded from this requirement.</p>	<p>(i) The Proposed Regulations Should Not Require Insurers To Resubmit Documentation On Disciplinary Matters</p> <p>Since the revised regulations have expanded the scope of inquiry regarding disciplinary actions beyond those imposed by the Securities and Exchange Commission, the commentator's suggestion would not be very effective because it would be inconsistent with the need to inquire about recent disciplinary matters. The previous disclosures would have centered on SEC disciplinary actions. In addition, the commentator has failed to account for situations where disciplinary actions may have been subsequently changed or even overturned on appeal.</p>

Comment No. 2:

Commentator: Randall A. Doctor, Barger & Wolen

Date of Comment: October 6, 2006

Type of Comment: Written

Summary of Comment:	Response to Comment: The Commissioner has considered the comment and has changed the proposed regulations in response to the comment.
<p>(a) The Non-Mutual Fund Provisions Of The Draft Regulations Lack Statutory Authority And Must Be Removed</p> <p>The commentator asserts there is no statutory authority for the imposition of a filing requirement and a filing standard upon filings involving non-mutual funds. The commentator argues that Insurance Code section 10506(h) relates only to changes relating to mutual funds. He asks that all of the non-mutual fund provisions should be removed from the proposed regulations.</p>	<p>(a) The Non-Mutual Fund Provisions Of The Draft Regulations Lack Statutory Authority And Must Be Removed</p> <p>The commentator ignores the language in Insurance Code section 10506(h) which states: “The commissioner may make reasonable rules and regulations as he or she considers necessary, proper, and advisable concerning the issuance and delivery of these policies and contracts and the payment of benefits thereunder and the manner in which the separate accounts shall be administered and which types of policies and contracts, if any, shall be subject to his or her approval prior to issue.” The commentator fails to address this portion of the statute in any of his comments.</p> <p>The proposed regulations have been promulgated, in part, as a response to AB 2788 which the Legislature enacted in 2002. The Commissioner is aware that the legislature was enacted to enable speedier processing of notifications of material changes by insurers. However, there is nothing in the enabling statute, Insurance Code section 10506(h), that prevents the Commissioner from setting reasonable standards governing what constitutes a complete filing.</p> <p>In addition, the proposed regulations are the Commissioner’s attempt to comply with AB 2788’s directive that the Commissioner promulgate regulations to supersede Insurance Department Bulletin 97-2. Whenever possible, the Commissioner has attempted to retain the same language that was used in Bulletin 97-2 because he is aware that insurers have become</p>

	<p>accustomed to working pursuant to the Bulletin. In addition, the Legislature saw fit to permit the use of Bulletin 97-2, even though it may be construed as constituting an underground regulation, pending the promulgation of these regulations.</p> <p>The commentator has offered no explanation why the Legislature permitted the Commissioner to continue to use Bulletin 97-2 which permitted the Commissioner to inquire about non-mutual fund investments.</p> <p>To accept the commentator's assertion that the Commissioner has no authority over non-mutual fund investments would create a dangerous and absurd situation. It would mean that the Commissioner could review and qualify a variable product that did not involve mutual fund investments, but could not review any subsequent changes to that variable product. The logic behind permitting material changes involving mutual fund investments is based upon the degree of federal regulation of mutual funds. However, non-mutual fund investments often are not subject to federal regulation. It is the Commissioner's duty to protect California consumers against risky unregulated investment schemes that are contained in a variable insurance product. To follow the commentator's logic completely, the public would be better off without the proposed regulations and Bulletin 97-2 should simply continue to be in force pursuant to AB 2788.</p> <p>However, upon further reflection, the Commissioner has decided to delete the language concerning material changes to non-mutual funds that was contained in the proposed Sections 2534.41, 2534.43 and 2534.45(a)(9).</p>
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Comment No. 3:

Commentator: Brad Wenger, Association of California Life and Health Insurance Companies and Carl B. Wilkerson, American Council of Life Insurers

Date of Comment: October 6, 2006

Type of Comment: Written

Summary of Comment:	Response to Comment: The Commissioner has considered the comment and has changed the proposed regulations in response to the comment.
(a) Section 2534.41(a) Should Be Amended To Change The Reference To The Investment Advisers Act of 2940 The commentator suggests that Section 2534.41(a) should delete the reference to the Investment Advisers Act of 1940. Instead, the reference should be to the Investment Company Act of 1940. The commentator notes that the investment instruments affected by these regulations are registered pursuant to the Investment Company Act of 1940.	(a) Section 2534.41(a) Should Be Amended To Change The Reference To The Investment Advisers Act of 1940 As noted earlier in this Amended Final Statement of Reasons, the earlier reference to the Investment Advisers Act of 1940 was the result of a typographical error to the statutory citation for the Investment Company Act of 1940. Accordingly, Section 2534.41(a) has been corrected to refer to the Investment Company Act of 1940.

ALTERNATIVES

The Commissioner has determined that no reasonable alternative exists to carry out the purpose for which the regulations are proposed.

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The proposed regulations do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.